State of California

Board of Equalization
Legal Division MIC:82

M e m o r a n d u m

570.0435

To : Mr. William D. Dunn (MIC:49)
Assistant Principal Tax Auditor

Date: May 19, 1995

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Subject: Section 6009.1 and Regulation 1668

This is in response to your memorandum dated March 21, 1995. We have discussed amending Regulation 1668 to explain the application of Revenue and Taxation Code section 6009.1 in the context of extax resale inventory. We decided, instead, to annotate the explanation. I note that different aspects of the rule set forth below are included in several annotations. (See BTLG Annots. 280.0040 (10/11/63), 280.0080 (11/22/55), 280.0360 (7/18/50), 280.0640 (3/15/60), 295.0660 (5/21/51), 430.0190 (11/26/90), 430.0192 (11/26/90), 432.0096 (5/17/90), 570.0438 (2/5/93), 700.0070 (9/9/91).)

Together, the annotations cited above explain that property given away is used when title to the property is transferred to the donee. If the purchaser transfers title to the donee outside California, the purchaser is not regarded as having used the property in California and California use tax therefore does not apply. If the purchaser transfers title to the donee inside California, the purchaser is regarded as having used the property in California at that time, regardless of whether the property is shipped outside California, and the purchaser owes use tax if it had purchased the property for resale or from outside California.

I note that there are only two possibilities in these types of circumstances: the purchaser must either be regarded as using the property at the time title passes (at the point of shipment) or as using the property when the donee receives the property. There is at least one state, Louisiana, that has adopted the latter reasoning, at least with respect to shipments of catalogs to recipients in its state, and it imposes tax on the use of the catalogs in Louisiana under such circumstances. (See D. H. Holmes Co. v. McNamara (1988) 486 U.S. 24.) California, however, has consistently concluded that a purchaser cannot "use" property within the meaning of our taxing statutes after all title, possession, and control of the property has been transferred to the donee. Thus, we impose tax when property is donated inside this state, even if the donation is accomplished by delivering the property to a common carrier for shipment to a donee outside the state. The reason for this is that title to the property passes to the donee at that time (cf. UCC § 2401) and the purchaser makes a complete use of the property at the time of title transfer.

Of course, if the rule in California were that there is no taxable use in California when property is donated in this state by delivering it to a carrier for shipment to a donee outside California, the theory would be that the use occurs upon receipt of the property by the donee.

Such a conclusion would mandate that we impose tax in situations where property is delivered to a common carrier outside California for shipment to a donee in this state. That is, the taxable use must occur in one of two locations, and if we were to change our rule on the first situation, we would have to change our rule on the second. There is, of course, no basis to do so.[1]

Our consistent and longstanding rule (over 40 years) as shown in the annotations cited above is that tax applies when the donated property is shipped to a donee from inside this state, but does not apply when the property is shipped from outside California to a donee in this state. However, the annotations cited above do not individually have a comprehensive statement of all relevant aspects of the rule related to shipments from this state, and we believe that it is appropriate to do so now in a single comprehensive annotation, with examples to make the application of the rule perfectly clear. Although some of our annotations are shorter than this one, its length is necessary for a comprehensive and understandable explanation. By copy of this memorandum, I am asking Mr. Nunes to annotate the following:

Withdrawals from Ex-Tax Inventory. "Storage or use" and "stored or used" within the meaning of subdivision (a)(2) of Regulation 1668 is storage or use in this state. A person who properly issues a resale certificate when purchasing property and thereafter uses the property solely outside California does not owe California use tax with respect to that out-of-state use. (See Regulation 1661 for the application of tax to out-of-state use of mobile transportation equipment which is purchased under a resale certificate for the limited purpose of leasing.)

Storage or use includes, but is not limited to, the withdrawal of property from resale inventory or other extax inventory (such as property purchased from outside California without the payment of California use tax) for functional use in this state by the purchaser and for the transfer of title in this state to other persons in transactions that do not constitute sales (e.g., making gifts, loans, donations, and transferring marketing aids for less than 50 percent of the purchase price). For example:

1. A person purchases 1000 watches under a resale certificate. The purchaser withdraws 100 watches from the California resale inventory and ships them to the purchaser's Nevada store. The Nevada store places 90 watches in resale inventory and makes a gift of 10 watches to its employees and customers. Under these facts, the purchaser continues to hold the 90 watches in resale inventory, and California use tax does not apply. The purchaser makes a use of the other 10 watches, but that use is in Nevada and is not subject to California use tax.

[1]If we were to change this interpretation of California's Sales and Use Tax Law, notwithstanding its over 40 years of consistent application, and instead taxed donations coming into this state, persons in that situation would certainly argue that we cannot do so. One argument that would be forcefully asserted would be that the Commerce Clause bars such taxation. That argument would fail. (D. H. Holmes Co. v. McNamara, supra.) Thus, as noted above, taxpayers cannot have it both ways, either one transaction or the other is taxable.

2. Same facts as above except the purchaser ships the 10 watches given to its customers and employees from California by common carrier. Under these facts, the purchaser uses the 10 watches given to customers and employees when the purchaser delivers the watches in California to the common carrier for shipment to donees outside California. There is no interstate commerce exemption for such use because it is not a sale in interstate commerce. The use in California is complete at the time of delivery to the common carrier. The purchaser owes California use tax on the purchase price of the 10 watches.

3. A person purchases 1000 watches under a resale certificate. The purchaser's logo is on the face of 100 of the watches and, at the time of purchase, the purchaser plans to give these 100 watches to its employees and customers for promotional purposes. The purchaser takes delivery of the 1000 watches in California and places them in its California warehouse. The purchaser sends all the watches to its Nevada store, and places 900 of them in resale inventory. The Nevada store distributes the 100 watches with the purchaser's logo to customers and employees without charge. The Nevada store also removes 50 other watches from Nevada resale inventory and distributes them to customers without charge.

Since the purchaser knew at the time of purchase that it would use, and not resell, the 100 watches with its logo, it was improper to issue a resale certificate for their purchase. Use tax is due on the purchase price of these 100 watches. The remaining 900 watches were purchased as a fungible, commingled lot, all or most of which the purchaser intended to resell. Since the purchaser did not know at the time of purchase which, if any, of the fungible, commingled lot would be withdrawn for use, the resale certificate was properly issued for their purchase. The subsequent withdrawal by the Nevada store of the 50 watches was a use outside California and no California use tax applies.

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